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In the Supreme Court of the United States

OCTOBER TERM, 1945

J. R. MASON, PETITIONER

v.

PARADISE IRRIGATION DISTRICT, RESPONDENT

PETITION FOR A REHEARING.

*To the Honorable Harlan Fiske Stone, Chief Justice
of the United States, and to the Honorable Asso-
ciate Justices of the Supreme Court of the
United States:*

Comes now J. R. Mason, petitioner *in propria per-
sona* requesting a rehearing on the judgment in the
above entitled cause, upon the following substantial
grounds:

The judgment, because it contains no language re-
solving the second question presented in the peti-
tion, which question raises squarely constitutional
and jurisdictional principles of fundamental impor-
tance, and because the question raised in a proceed-
ing under Chapter IX of the Bankruptcy Act, has

not been settled by this Court by any case cited by respondent, or in the judgment, it is again respectfully presented, as follows:

Whether the judgment contravenes the well settled rule that State law and decisions govern the substantive and procedural rights of holders of the bonds of a State, or its Political Subdivisions, issued under authority of the sovereign power of the State to borrow money, and that such power when exercised, is immune, with or without State consent, from the will of Congress, or its Courts.

Petitioner is not discussing the constitutionality of the amended Chapter IX of the Bankruptcy Act, which forms the base of the instant proceeding, but only whether federal or state law and decisions govern and control his substantive and procedural rights embodied in the valid, binding and unpaid bonds and interest coupons shown in his proof of claim (R. 161) which are impaired by the decree below, which decree includes a restraint involving the levy and collection of taxes, unauthorized by any law. (R. 53.)

The bonds owned by petitioner, which the instant judgment impairs, are merely evidences of the exercise of a sovereign State activity, promising the holder repayment from State-owned property. They thus "partake of uniqueness from the point of view of intergovernmental relations, inherently constituting a class by themselves" within the classification still

remaining immune from the sphere of sovereignty of the federal government, as that boundary was reaffirmed by this Court on January 15, 1946, in the *State of New York v. U. S.* # 5 judgment.

The activities which respondent has been delegated authority to exercise by the State, were clearly and unequivocally ruled as "exclusively governmental" in *El Camino v. El Camino I. D.*, 12 Cal. (2d) 378. Dictum by this Court in *Brush v. Comm.*, 300 U. S. 352, 366-369, is also submitted in proof of the nature of the activities of respondent.

This Court said, in its judgment, "Being unable to collect taxes sufficient to service the bonds * * *". Has this Court not steadfastly adhered to the principle that the ability or inability of states, or of their tax instrumentalities, to collect such direct *ad valorem* land taxes as are involved here, "uniquely" a function of the state, presents no federal question, and threatens no federal right? No more would the inability of Congress to collect taxes on imports threaten a state function. Petitioner had supposed this rule of reciprocal immunity was settled in *Pollock v. Farmers L. & T. Co.*, 158 U. S. 601, and *Arkansas Corp. v. Thompson*, 312 U. S. 673, 313 U. S. 362.

In *Wilson v. Standifer*, 184 U. S. 399, 412, this Court said:

"Especial respect should be had to such decisions when the dispute arises out of general laws of a State, regulating its exercise of the taxing power,

or relating to the State's disposition of its public lands."

The instant dispute clearly "arises out of the general laws of a state; regulating its exercise of the taxing power, and relating to the State's disposition of its public (tax-revested) lands." The state law governing the rights of petitioner, and the RFC claim and the powers and duties of respondent, was construed by this Court in *Fallbrook I. D. v. Bradley*, 164 U. S. 112. There has been perhaps no state law oftener before the California and Federal Courts since that historic decision in the *Fallbrook* proceeding, and nearly always because it was contended that some district was "unable to collect taxes". A few of the subsequent cases are,

Tulare I. D. v. Shepard, 185 U. S. 1;
Herring v. Modesto I. D., 95 Fed. 705;
W. U. Tel. Co. v. Modesto I. D., 149 Cal. 662;
So. Pac. Co. v. Stibbens, 103 Cal. App. 609;
Board of Directors v. Tregea, 88 Cal. 334;
Boskowitz v. Thompson, 144 Cal. 724;
In re Madera I. D., 92 Cal. 296;
Wore v. Imperial I. D., 193 Cal. 609;
El Dorado I. D. v. Browne, 216 Cal. 269;
San Diego v. Childs, 217 Cal. 109;
Bates v. McHenry, 123 Cal. App. 81;
Willard v. Glenn-Colusa I. D., 201 Cal. 726;
Selby v. Oakdale I. D., 140 Cal. App. 171;
Shouse v. Quinley, 3 Cal. (2d) 357;

Meyerfeld v. S. San Joaquin, 3 Cal. (2d) 409;
Moody v. Provident I. D., 12 Cal. (2d) 389;
Fallbrook v. Cowan, 131 Fed. (2d) 513 (cert.
 denied).

State laws governing the rights of both the RFC and of petitioner afford complete means for dealing with this dispute. Those laws are in force. They are the laws to which resort must be had to validly effectuate any "composition" which Chapter IX of the Bankruptcy Act on which this proceeding is based, may have been enacted to facilitate. There is nothing in Chapter IX which nullifies the valid, existing state laws out of which the dispute here arises. It is not shown that the claims of RFC or petitioner involve a function within the control of the Congress, or its Courts, or that this Court has ever so ruled, in a dispute based on any federal statute which springs from either the taxing or bankruptcy clause. Therefore, the judgment in the instant case is inconsistent with the rule that "we should give full faith and credit to the acts of sovereign States", decided in *N. Y. Chgo. & St. L. R. Co. v. Frank*, 314 U. S. 361, 366. The *Moody v. Provident* case, supra, brings the bonds owned by petitioner clearly and unequivocally under the rule stated by this Court in the *Pillsbury* case (105 U. S. 278), as follows:

"The annual tax was the security offered creditors; and it could not be afterward severed from the contract."

"It is universally held that real or immovable property is exclusively subject to the law of the country or state in which it is situated, and no interference with it by the law of any other sovereignty is permitted." 11 Am. Jur., Conflict of Laws, §30.

This constitutional principle was adhered to in a dispute over the scope of federal v. state power arising out of the claims of a private holder of a land-title in *Skaggs v. Comm.*, 122 Fed. (2d) 721 (cert. denied No. 866, March 2, 1942).

In *The Federalist*, XXXIII, by Hamilton, the following cogent language appears:

"Suppose, again, that upon the pretence of an interference with its revenues, it should undertake to abrogate a land-tax imposed by authority of the State; would it not be equally evidence that this was an invasion of that concurrent^c jurisdiction in respect of this species of tax, which its Constitution plainly supposes to exist in the State governments? If there should be a doubt on this head, the credit of it will be entirely due to those reasoners who, in the imprudent zeal of their animosity to the plan of the convention, have labored to obscure the plainest and simplest truths."

In *International Shoe Co. v. Washington*, No. 107, decided Dec. 3, 1945, Mr. J. Black concurring, said:

"I believe that the Federal Constitution leaves to each State, without any 'ifs' or 'buts', a power to tax. * * * I think it a judicial deprivation to con-

dition its exercise upon this Court's notion of fair play, however appealing that term may be * * *

Petitioner fully agrees that the "purpose" of Chapter IX is to "provide taxing agencies with a method of ~~sealing down their debt structures~~", as said in the instant judgment. But it was the same "purpose" that prompted the passage of the original Chapter IX, 11 U. S. C. § 301-304 denounced as unconstitutional for that very reason, by this Court in the *Ashton* case. (298 U. S. 513.)

A great liberal jurist, Louis D. Brandeis warned, "Experience teaches us to be most on our guard to protect liberty when the government's *purposes* are beneficent".

In the instant judgment, it is said, "But as we have seen, it (the amended Chapter IX) has statutory sanction", which still leaves unresolved the question again here presented. The right of congress to lay taxes on incomes has not only statutory but constitutional sanction, despite which fact the right does not reach so far as to permit congress to deprive petitioner of any interest payable under the bonds at bar by means of a federal tax, notwithstanding the broad language in the 16th Amendment. (30 Ops. 352, Jan. 31, 1914, 38 Ops. 563, Feb. 1, 1937 by U. S. Attorney General.)

Nothing said in the *Bekins* case (304 U. S. 27) expressly reversed the immunity principle decided in the *Ashton* judgment, as follows:

"The difficulties arising out of our dual form of government, and the opportunities for differing opinions concerning the relative rights of the state and national governments are many; but for a very long time this Court has adhered steadfastly to the doctrine that the taxing power of Congress does not extend to the States or their political subdivisions. The same basic reasoning which leads to that conclusion, we think, requires like limitation upon the power which springs from the bankruptcy clause."

No federal right is here threatened, if petitioner prevails, because the substantive rights of both the RFC and petitioner are of such character as to make them fiscal affairs within the sovereign power of the state exclusively, governed by the constitution and laws of the state as construed by the state Courts, and both equally secured against impairment by the contract clause in the federal constitution. Neither the claim of the RFC (R. 12), nor of petitioner (R. 161), is any more within the power of the federal government to "scale down", than to "add to", because of explicit inhibitions in the federal and state constitutions.

It would seem to be no more inconsistent with constitutional principles if California had, by simple statute, attempted to allow its citizens to be freed from paying lawful federal import duties, irrespective of federal law, than to permit feudal forces to escape

paying the direct *ad valorem* land taxes as required by state law and decisions, and keep the land in violation of law. The sphere of federal sovereignty can not be enlarged by the "consent" of the creditors of a state, or its taxing agency, no matter how greatly in the "majority" the willing creditors may be. Neither can the federal sphere be enlarged by the "consent or submission" of a state, but only by amending the constitution, in the manner therein provided. No state law or decision authorizes respondent to fail, refuse or neglect to levy and collect the direct *ad valorem* land taxes annually, required by the constitution and laws in effect, when petitioner's bonds were issued, which laws are still in full force and effect, as Chapter 368, Statutes 1943. These state taxing laws are not within the sphere of the sovereignty of the federal government, because their execution involves no federal right. While there is no contract relationship between private holders of land titles, as taxpayers and the state (*Wood v. Lovett*, 313 U. S. 362), there is a contract relationship between the state, or its taxing agencies and their bondholders as fully as with an investor in tax-delinquency deeds. It was because of this principle that this Court reversed the judgment announced by the Arkansas Supreme Court, in *Wood v. Lovett*, supra, despite the argument in that case that state decisions are supreme. Here, the tables are turned. The rights of petitioner have been fully construed and protected

by the California Supreme Court, in the cases heretofore cited, and the property rights of the RFC are equally governed by the same state laws and decisions, from which state law the power of respondent to make contracts with the RFC or others is derived and limited. The so-called state consent (Chapter 72, Statute 1939) is "a subsequent exertion of the legislative power", such as was prohibited by this Court in *Cross Lake Club v. La.*, 224 U. S. 632, 638-39, and in *Wood v. Lovett*, *supra*, by the contract clause.

The judgment, in construing the 1934 contract between the RFC and respondent as one that required or even contemplated "all holders agreed to the refinancing program", is a complete misconception of the facts. That contract was executed by the RFC under the provisions of Section 36, Public No. 78, 73rd Congress, which statute permitted the RFC to disburse such loans only *after* it "has been satisfied that an agreement has been entered into between the applicant and holders of its outstanding bonds or other obligations under which the *applicant* will be able to purchase or refund all *or a major portion* of such bonds * * * at a price determined by the corporation to be reasonable * * * ." It is this statute which measures the scope of the loaning power delegated to the RFC. It does not permit the RFC to buy the bonds to be refunded and hold them as owner, nor to do indirectly what the RFC cannot

directly do. The fact that the loan contract was executed and that the RFC disbursed its funds in 1934 (R. 86, 87), three years before 11 U. S. C. 401-403 (Chapter IX) was enacted, is not only *prima facie* that this 1934 contract was executed only after the RFC was "satisfied" that respondent had agreements with a sufficient "portion" of the holders of original 6% bonds, or else the RFC was not permitted to disburse the loan proceeds, when it did. When the original holders accepted the "price determined by the RFC to be reasonable" for their bonds, in 1934, there was no federal statute, such as forms the base of the instant proceeding. (11 U. S. C. 401-403.) Hence the opinion of this Court "that creditors owning not less than 92% of the bonds had accepted the plan and consented to filing the petition" is wholly unsupported, because it was the RFC and not the original bondholders who signed the so-called consent (R. 12) to this proceeding, three years after the RFC loan was disbursed, and after the 92% had accepted the RFC figure in full settlement. Also respondent did not deny the point raised in the petition at pages 7 and 8 that the 1934 contract entitles the RFC to 4% refunding bonds, and to get no more or less, "regardless of the outcome of this proceeding". The RFC consent is carefully worded, and makes no claim that the RFC is the "owner" of the \$447,000 bonds it "now holds". If such an artfully worded "consent" had been filed by any ordinary bankers, would

it have met the "good faith" test? In any event, the above establishes that the RFC loan of 1934 had no requirement in it that "all holders" sell, at the RFC figure, nor any requirement or condition in it, about any "plan of composition", hence, is not the opinion of this Court that "RFC has ventured the capital necessary to effectuate the plan of composition" erroneous? Where is anything in the record, or elsewhere to support the view expressed by the Court that there is any condition in, or even any reference to "a plan of composition" in the contract of 1934? But, even if there had been such a provision in this 1934 contract, how could it be validly given an effect which would impair the claim of petitioner (R. 161-163) which, under the rule of law again affirmed by this Court in *Huddleson v. Dwyer*, 322 U. S. 232, is governed by state law and decisions? It does not lie within the power delegated to congress to "interfere" with state law and decisions, if such action would benefit those who loaned money to a state, or to its local taxing agencies, because that would operate to increase the direct *ad valorem* taxes permitted under state law. The instant proceeding, insofar as it adversely affects the claim of petitioner, is not authorized by any valid law, and its sole force and effect, if it stand, will be to free private holders of land titles from direct *ad valorem* taxes mandatory under applicable state law and decisions, and to give them an unearned increment at the sole ex-

pense of petitioner by the amount of his claim, disallowed.

The cases cited in the petition, and in the brief (Appendix III, IV) clearly and unequivocally sustain this view of the rights and duties involved.

With regard to the remark of this Court, that "The alternative would be to abandon this type of refinancing", it is respectfully suggested that since the judgment in the *Faitoute v. Asbury Park* case, 316 U. S. 502, the way has been cleared for the states themselves to put their own houses in order, without shifting the job to Congress, or to its Courts, and Statutes designed to do the job were enacted by the California Legislature in 1937 (Chap. 24, Stat. 1937) which have not been repealed. This statute was quickly passed, after the *Ashton* case, but it was not used after the amended Chapter IX was held "not unconstitutional" in the *Bekins* case, 304 U. S. 27, which case reached this Court on a simple demurrer, and presented no questions, as an actual controversy, as here. The rapid abdication by the States from their duties, not only with regard to properly looking after their own local units of government, but also in failing to levy and collect a fairer share of their own expenses, and the resultant pressure for bigger and better subsidies and handouts from the federal treasury to meet the costs of education, roads, water supplies, etc., traditionally state affairs, is evidenced by examining the total federal, state and local taxes collected in this state, 1934.

to 1944. The study reveals that whereas about 50% of all taxes (federal, state and local) in 1934, were raised as direct *ad valorem* taxes by the state, on "local property", a steady and rapid shift in percentages occurred each year thereafter, until in 1944 less than 8% of the total taxes collected were derived from such direct taxes on "local property". An inquiry into the record in other states, might suggest the major cause of the present reconversion problems. The total of taxes being collected on incomes, and on the fruit of man's work, is depriving the producers of incentive, tending to lessen production, and increase the cost of things which the consumer buys. The only known antidote for this trend, is for government to increase taxes on land values or economic rent, which are not the same as taxes on land. They are taxes only on the private holders of a special privilege, the holding of sites or locations enjoying the advantages of public services and advantages (such as a dependable water supply for irrigation and domestic purposes acquired by respondent with money loaned by petitioner), the possession of which gives the title holder, as such, but not the land user, the power of privately appropriating an unearned increment, measured by the net economic rent, after taxes. What a tax on land values takes, therefore, is only part of what the user of land is, or would be required by the title holder to pay, as rent for the privilege of using that location, for a farm, buildings, shop, mine or home. It thus

never falls on the user of land, as such, never increases production costs, and never adds to prices. This is the only species of tax respondent is authorized to levy and collect. The economic effect of this taxation was described in 1911 by the Modesto Irrigation District, as follows:

"As a result of the change in taxation (authorized in Stat. 1909, p. 461), many of the large ranches have been cut up and sold in small tracts. The newcomers are cultivating their farms intensively. The new system of taxation, in collecting all of the taxes from the value of the land, has brought prosperity. Farmers are now encouraged to improve their property. Industry and thrift are not punished by increase in taxes. In the Modesto Irrigation District the man who builds a house or barn will not have his irrigation tax increased. He will pay no more than his neighbor who allows weeds to grow on his land."

Thus, it is certain, that the sole interest standing to gain, in this proceeding, is not the RFC nor respondent, but only the speculator in land titles, wishing to hold land "as an investment", without paying the taxes required by law.

Secretary of the Interior H. L. Ickes expressed the basic problem cogently in a letter printed in the *San Francisco News*, November 12, 1945, when he said:

"It is the age-old battle over who is to cash in on the unearned increment in land values created by a public work."

William Allen White, in an editorial in his *Emporia Gazette*, August 20, 1941, wrote:

“Congress is defining its powers so broadly that it is beginning to consider the regulation of rent—rent from land. Congress surely has the power to regulate the rent that any person may appropriate. *If Congress would subject the rental value of land to its taxing power*, Congress could fix rent problems *at the source*. It could tax idle lands which produce neither guns nor butter, into coming into whatever productive capacity they have.”

This Court recently denied certiorari in the case of *Cowan v. Fallbrook*, 131 F. (2d) 513, denying a private holder of land-title, who had failed to pay the Irrigation District tax within the period of 3 years allowed, the privilege of filing a petition under Section 75 of the Bankruptcy Act, and holding that the deed conveyed to the Irrigation District, the “absolute title for all purposes”. It has long been the rule, that the lien for any unpaid irrigation tax is ahead of an earlier mortgage, or private lien of any kind. *Williams v. Cooper* (1899), 124 Cal. 666. In *Anderson-Cottonwood v. Klukkert*, 13 Cal. (2d) 191, it was held squarely that land acquired by respondent for unpaid taxes is land owned by the state, immune from taxation by any other taxing agency. That decision emerged after many years of conflicting antecedent judgments, some of which are reviewed in 23 California Law Review, March, 1935, page 264. Under the provisions

of Chapter 9, Part 6, Division 1 of the California Revenue and Taxation Code, respondent has the right to become and to continue to be the exclusive rental agency, and to collect the "rents, issues and profits", the same as the former private title holder. Stats. 1943, Ch. 368, Sec. 26301. Had respondent adhered to the law, and administered tax revested land in the manner therein provided, farm and home seekers would have an opportunity of possessing a site in this District, and without having to pay tribute to some speculator in land titles for that privilege, or at least, not as heavy a tribute as is being demanded today for choice locations, within the taxable boundaries of respondent.

The instant judgment, in holding that there is no showing of discrimination between creditors, appears to have missed the definite showing in the petition at page 4, and in the brief for petitioner, at page 8, ending with "The discrimination is clear". In the event this showing does not make it clear, respondent has paid interest and principal due to RFC in full of the claim held by RFC, and no interest whatever has been paid petitioner upon his claim since 1937. (R. 134.)

Under the rule applied in *Wright v. Coral Gables*, 137 Fed. (2d) 192, by the Fifth Circuit and sustained by this Court in 64 S. Ct. 779, by a 4 to 4 vote, the payment of \$3035.95 to petitioner in December, 1936 and January, 1937 (R. 199) constitutes a deviation

from and abandonment by respondent of the program of refinancing, begun in 1934, and presented as the "Plan of Composition" in the proceeding under the original Chapter IX against petitioner, which was dismissed October 28, 1936 upon the ground "that the Court is without jurisdiction". No appeal was taken from this judgment. (R. 88, 89.)

• If the approval of the creditors "owning not less than 92%" of the original 6% bonds is taken as the effective consent for the second proceeding, it clearly was a consent to accept 52.521 cents flat, but not 52.521 cents, plus \$3035.95 interest to petitioner. If the consent from the RFC, filed with the second petition (R. 12) is the effective consent, it contains no claim that the RFC is the owner of original 6% bonds, and hence the allegation in the petition (R. 2) "That creditors owning not less than 92% in amount of the bonds and other evidences of indebtedness of petitioner and affected by the plan of composition and debt readjustment proposed herein, have accepted such plan in writing and consented to the filing of this petition * * *" is a misrepresentation.

• Therefore, because of this \$3035.95 payment to petitioner in 1936 and 1937, he can not be properly grouped with the original 6% bondholders, who in 1934 accepted 52.521 cents as payment in full, or with the RFC, whose claim is not adversely affected by the proceeding, as required by Section 83(d), 11 USC 403(d). Nothing in the statute indicates that Congress author-

ized its Courts to group as a class, creditors who on the face value of the same bonds have gotten different equivalents, or who have antagonistic interests, as clearly exist between the RFC and petitioner.

This Court said in *Doty v. Love*, 295 U. S. 64:

"The creditors favoring reorganization, though they be 99%, have no power under the statute to impose their will on a minority. They may advise and recommend, but they are powerless to coerce."

In *Helms v. Holmes*, 129 F. (2d) 263, 266, the 4th Circuit Court said: " * * a discharge in bankruptcy is neither a payment nor an extinguishment of debts. (Nor of taxes.) It is simply a bar to their enforcement by legal proceedings." Hence a "discharge", if effective here, restrains the collection of taxes not authorized by any law relating to bankruptcy, and prohibited by 265 Jud. Code, 28 USCA §379.

The judgment, in quoting with approval certain political speeches from 81 Cong. Rec. 6313 branding minority holders of valid obligations, "Hold-up men operating *within* the law" seems a bit paradoxical. Just how any person "operating within the law" is justly branded a "Hold-up man" by this Honorable Court, is not explained. It is not denied that the claim of petitioner (R. 161) is "within the law"; and is unpaid. Therefore, the only "Hold-up" with which he can be justly charged, is the hold up of feudal interests, which seek plunder "without the law". Unless

held in check, they have grown into a giant force in Prussia, and elsewhere during the two recent world wars, fully as destructive as the atomic bomb. Petitioner makes no apology for trying to "Hold-up" outlaws, whether operating in East Prussia or in the United States. A reading of the antecedent petitions and briefs, and petitions for a rehearing filed with this Court since 1941 by petitioner herein, will more fully explain not only the Constitutional, but the economic and sociological principles petitioner has been attempting to defend. They are the basic principles of Thomas Jefferson, Abraham Lincoln, and of this Honorable Court, and not in any respect the principles of a "Hold-up man".

What happens to the property of petitioner is of secondary importance to the principle of dual sovereignty involved in this dispute, and which the instant judgment contravenes, as clearly as though the decree of the Court below had issued under a simple federal statute springing from the tax clause. In the light of this Court's language in the *New York v. U. S.* case, *supra*, as follows, "There are, of course, State activities and State-owned property that partake of uniqueness from the point of view of inter-governmental relations. These inherently constitute a class by themselves", the instant judgment, if it stand can only further affirm the prophecy of Mr. J. McReynolds dissenting in *Graves v. N. Y.*, 306 U. S. 466, 477, when he said: "But safely it may be said

that presently marked for destruction is the doctrine of reciprocal immunity that by recent decisions here has been so much impaired."

Wherefore, petitioner respectfully prays that the judgment be reversed, and the proceedings directed to be dismissed, and that petitioner have such other relief as to this Honorable Court may seem meet and just.

Dated, San Francisco, California,

January 25, 1946.

J. R. MASON,

Petitioner in Propria Persona.

CERTIFICATE.

I, J. R. Mason, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

Dated, San Francisco, California,
January 25, 1946.

J. R. MASON,

Petitioner in Propria Persona.

SUPREME COURT OF THE UNITED STATES.

No. 306.—OCTOBER TERM, 1945.

J. R. Mason, Petitioner, vs. Paradise Irrigation District.	} On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Cir- cuit.
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[January 7, 1946.]

Mr. Justice DOUGLAS delivered the opinion of the Court.

Respondent is organized under the laws of the State of California and located in the County of Butte of that State. It experienced financial difficulties in the 1930's. It had outstanding \$476,000 principal amount of bonds bearing interest at the rate of 6 per cent. Being unable to collect taxes sufficient to service the bonds, it tried to work out a debt readjustment program. It applied for a loan from the Reconstruction Finance Corporation. A loan of \$252,500 was arranged, provided all the holders of the outstanding bonds agreed to the refinancing program. The offer to the bondholders was that they surrender their bonds for 52.521 cents on each dollar of principal, exclusive of interest—an amount which respondent deemed fair to the bondholders and to the owners of the land in the district. The holders of about 92 per cent of the principal amount of the outstanding bonds agreed. Respondent, being unable to obtain the assent of the holders of the remaining bonds, filed its petition under Ch. IX of the Bankruptcy Act late in 1937. 50 Stat. 653, 52 Stat. 939, 54 Stat. 667, 11 U. S. C. § 401. It submitted with its petition its plan of composition or debt readjustment and prayed, *inter alia*, that the plan be approved. The plan provided that the holders of the outstanding bonds be paid in cash 52.521 cents on each dollar of principal, exclusive of interest; that the cash was to be supplied from the proceeds of a loan of \$252,500 from the Reconstruction Finance Corporation; that the Reconstruction Finance Corporation was to receive new or refunding 4 per cent bonds in the principal amount of its loan, and 4 per cent on all disbursements from the date thereof until the new or refunding bonds were issued to it. The petition recited that the creditors owning not less than 92 per cent in amount of the bonds had accepted the plan and consented to

the filing of the petition.¹ It appears that the consenting bondholders had deposited their bonds under the plan; that the Reconstruction Finance Corporation did not advance the funds to respondent but, acting through a bank, purchased the bonds at the composition figure and registered the bonds in its name; that in accordance with the terms of the contract between respondent and the Reconstruction Finance Corporation, the old bonds so acquired remained obligations of respondent, were held by the Reconstruction Finance Corporation as security for its advances and are to be exchanged under the plan for 4 per cent refunding bonds. The Reconstruction Finance Corporation, as holder of about 92 per cent of the bonds, approved the plan prior to the filing of the petition under Ch. IX.

The District Court found that all of the outstanding bonds were of one and the same class,² that the requisite percentage of bondholders had approved the plan,³ that respondent was unable to meet its debts as they matured,⁴ and held that the plan was fair, equitable and for the best interests of its creditors and did not unfairly discriminate in favor of any creditor.⁵ It accordingly approved the plan.⁶

Petitioner is the owner of \$29,000 principal amount of the old bonds who opposed the plan of composition. His objections were not sustained in the District Court. The Circuit Court of Appeals likewise overruled them. 149 F. 2d 334. The case is here on a petition for a writ of certiorari which we granted because of a

¹ Sec. 403(a) requires the petition to state, *inter alia*, that "creditors of the petitioner owning not less than 51 per centum in amount of the securities affected by the plan (excluding, however, any such securities owned, held, or controlled by the petitioner), have accepted it in writing."

² Sec. 403(b) provides that "the holders of all claims regardless of the manner in which they are evidenced, which are payable without preference out of funds derived from the same source or sources shall be of one class. The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute a separate class or classes of creditors."

³ Sec. 403(d) provides that a plan of composition shall not be confirmed, with exceptions not material here, "until it has been accepted in writing, by or on behalf of creditors holding at least two-thirds of the aggregate amount of claims of all classes affected" by the plan, excluding "claims owned, held, or controlled by the petitioner."

⁴ Sec. 403(a) requires the petition to state that the petitioner is "insolvent or unable to meet its debts as they mature." Among the findings required by § 403(c) for confirmation of a plan is that it "complies with the provisions of this chapter."

⁵ That finding is required by § 403(e).

⁶ November, 1943.

conflict among the Circuit Courts of Appeals,⁷ limited to the question whether it was proper to approve a plan which treated petitioner differently from the Reconstruction Finance Corporation.

Petitioner argues that since he and the Reconstruction Finance Corporation were put in the same class, the rule of "equality between creditors" applicable in bankruptcy proceedings (*Clarke v. Rogers*, 228 U. S. 534, 548) required that they be treated alike. In other words, he contends that instead of being required to take 52.521 cents in cash on each dollar of principal, he should receive 4 per cent refunding bonds.

We held in *American United Mutual Life Ins. Co. v. Aron Park*, 311 U. S. 138, 147, that the principle of equality between creditors governed compositions under Ch. IX, as it did compositions under the old § 12. The fact that the Reconstruction Finance Corporation holds the vast majority of all the bonds and therefore is in a dominant position in the reorganization does not mean that it is entitled to preferred treatment. It is clear that it is not. *American United Mutual Life Ins. Co. v. Aron Park*, *supra*, p. 148. The Reconstruction Finance Corporation has not by purchasing bonds in the market acquired merely a speculative position in the plan of composition. Nor is it merely in the position of a holder of a majority of the bonds. By contract with the debtor it has underwritten the whole refinancing program. It has ventured the capital necessary to effectuate the plan of composition. It has long been recognized in reorganization law that those who put new money into the distressed enterprise may be given a participation in the reorganization plan reasonably equivalent to their contribution. *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 117, 121-122 and cases cited; *Ecker v. Western Pacific R. Corp.*, 318 U. S. 448, 486-487. That rule is based on practical necessities. Without the inducement new money could not be obtained.

It is said, however, that the Reconstruction Finance Corporation when it becomes the holder of bonds must be treated on the basis that it is a creditor and not an outside lender of money. It is clear that Congress intended the Reconstruction Finance Corporation to be treated in situations like the present as a creditor. Sec. 402 of the Act provides that "Any agency of the United States holding securities acquired pursuant to a contract with any petitioner under

⁷ *Texas v. Tabasco Cons. Ind. School Dist.*, 132 F. 2d 62, 133 F. 2d 196, decided by the Fifth Circuit Court of Appeals, is to be contrasted to the decision below and to *West Coast Life Ins. Co. v. Merced Irrig. Dist.*, 114 F. 2d 654, decided by the Ninth Circuit Court of Appeals and also to *Luehrmann v. Drainage Dist.*, 104 F. 2d 696, decided by the Eighth Circuit Court of Appeals.

this chapter shall be deemed a creditor in the amount of the full face value thereof." The Reconstruction Finance Corporation is such an agency. Sec. 403(j) gives securities acquired, as here, pursuant to a plan of composition prior to the filing of a petition the same recognition as any other securities.⁹ It is thus apparent that securities acquired by the Reconstruction Finance Corporation, pursuant to a plan of composition, are not extinguished, remain securities "affected by the plan",⁹ and may be computed in determining the percentage of consenting creditors necessary for the filing of a petition under Ch. IX.¹⁰ If the Act were construed as requiring the Reconstruction Finance Corporation in situations like the present to be treated as every other creditor of the same class, the fact that it had underwritten the whole refinancing program would be considered irrelevant. But as we have seen, he who furnishes new capital to a distressed enterprise has long been accorded preferred treatment. The Reconstruction Finance Corporation contributes something that Mason does not. It furnishes the underwriting which makes the refinancing possible. It gives something of value for the preferred treatment which it receives. The other security holders of the same class give nothing new. That difference warrants a difference in treatment. *Case v. Los Angeles Lumber Products Co.*, *supra*; *Ecker v. Western Pacific R. Corp.*, *supra*. The plan, of course, must be fair and equitable and it must "not discriminate unfairly" in favor of any creditor. § 403(e). A secret advantage would not meet that test. *American United Mutual Life Ins. Co. v. Avon Park*, *supra*. But here there was full disclosure to the security holders and to the court. Petitioner receives 52.521 cents on each dollar of principal amount of his bonds. The Reconstruction Finance Corporation receives new and refunding bonds in the face amount of its cash advances. It is, of course, possible that 52.521 cents in cash may not be as advantageous an offer as 52.521 cents in

⁹ Sec. 403(j) reads as follows: "The partial completion or execution of any plan of composition as outlined in any petition filed under the terms of this title by the exchange of new evidences of indebtedness under the plan for evidences of indebtedness covered by the plan; whether such partial completion or execution of such plan of composition occurred before or after the filing of said petition, shall not be construed as limiting or prohibiting the effect of this title, and the written consent of the holders of any securities outstanding, as the result of any such partial completion or execution of any plan of composition shall be included as consenting creditors to such plan of composition in determining the percentage of securities affected by such plan of composition."

⁹ For a discussion of the history of § 403(j) see *West Coast Life Ins. Co. v. Merced Irrig. Dist.*, *supra* note 7, pp. 667-668.

¹⁰ See note 1, *supra*.

new and refunding bonds. But there is no showing that it is not. Hence it is impossible for us to say that, although a difference in treatment was warranted, any discrimination in favor of the Reconstruction Finance Corporation was so great as to be unfair.

A different question arises when we come to the classification of creditors for voting on a plan of composition. Sec. 403(b) provides that there shall be put in one class holders of all claims payable without preference from the same source.¹¹ While this provision states the general rule, we said in *American United Mutual Life Ins. Co. v. Avon Park*, *supra*, p. 146, that the bankruptcy court has the power to make a different classification where inequitable results would otherwise obtain. We assume that a majority bondholder who was receiving preferred treatment under a plan by reason of his underwriting or otherwise would normally have to be put in a different class when it came to voting on the plan. But we see no reason why Congress could not provide otherwise. As we have seen, § 402 allows the Reconstruction Finance Corporation to be treated as a creditor in the amount of the full face value of the securities it acquired. By reason of § 403(j) those securities may be included in the percentage of consenting securities necessary for the filing of a petition under Chapter IX. Those provisions were inserted to make these refinancing programs possible and practical. They give statutory sanction to this particular method of refinancing. Sec. 403(d) requires approval by creditors "holding at least two-thirds of the aggregate amount of claims of all classes" affected by the plan.¹² If that is construed to mean not two-thirds of each class but two-thirds of the total amount of all claims in all classes, the separate classification of the Reconstruction Finance Corporation would make no difference in result in the present case. For all of the bonds held by it are more than two-thirds of the aggregate amount of all claims affected by the plan. Only if the Act were construed to mean that two-thirds of each class is necessary for approval of a plan would the separate classification of the Reconstruction Finance Corporation produce a different result in this case. Such a construction, however, would place the success of these refinancing programs at the mercy of the minority interests. If it were necessary in this type of case to put non-assenting bondholders in a separate class, they could block the refinancing program even though it were fair and equitable and the only feasible one which the debtor could work

¹¹ See note 2, *supra*.

¹² See note 3, *supra*.

out. In designing this legislation Congress was solicitous not only to protect the position of the Reconstruction Finance Corporation in these refinancing programs¹³ but also to give this class of debtors a workable and practical method of obtaining relief from oppressive debt burdens. That purpose would be thwarted or impeded if we gave Ch. IX a construction which placed the fate of these plans in the hands of minority, non-consenting bondholders. The aim to provide a method of forcing "recalcitrant minority creditors into agreement" (H. Rep. No. 517, 75th Cong., 1st Sess., p. 3) would be defeated. For once such a rule were announced minority bondholders would have a great nuisance value, making it worthwhile for them to lie back until they got their price.¹⁴

It is suggested that the plan might be approved without the consent of the minority if, as provided in § 403(d) "provision is made in the plan for the protection of the interests, claims, or lien of such creditors or class of creditors." Provision "for the protection" of the claims of non-assenting creditors could be made by leaving them undisturbed. But the purpose of Ch. IX is to provide taxing agencies with a method of scaling down their debt structures and reducing their debt service requirements when the need for relief is shown. If the non-assenting creditors had the option to come in under the plan or to retain their old securities, the debtor would be unable to get the relief which Ch. IX affords, or could do so only on such terms as the minority dictated. The other alternative would be to abandon this type of refinancing. But as we have seen, it has statutory sanction. It is said, however, that provision "for the protection" of the claims of non-assenting creditors could be made in ways other than leaving the claims undisturbed. If, *arguendo*, we assume that is true, we see no reason why payment in cash of the full value of the claims would not be adequate. That is permissible in connection with reorganizations under Ch. X. 52 Stat. 840, 11 U. S. C. § 616(7). It is indeed the historic method of dealing with dissenters under plans

¹³ That the Reconstruction Finance Corporation would play an important role in these refinancing programs was in the forefront when this legislation was before Congress. See H. Rep. No. 517, *supra*, p. 4; 81 Cong. Rec. 6322.

¹⁴ Congressman Sumners, Chairman of the House Judiciary Committee, stated during the debate: "The force of the bill is directed against that minority present in every effort of debtors and creditors to bring the total of amounts payable within the ability of the debtor to pay. It is the minority who try to take advantage of the general desire to settle to compel an advantage to themselves in order to remove their selfishly interposed obstruction. They are hold-up men operating within the law." 81 Cong. Rec. 6313. The same view was expressed by Senator Pepper who managed the legislation on the floor of the Senate. 81 Cong. Rec. 8543.

of reorganization. *Case v. Los Angeles Lumber Products Co., supra*, p. 121, note 15. No reason is apparent why, under our assumption, the same could not be done under Ch. IX. Yet, even in that view, the present plan was properly confirmed. For there is no showing whatsoever that the full value of Mason's claims is more than 52.521 cents on the dollar which he receives in cash. The District Court, indeed, found that the cash offer was fair and equitable and we are unable to say that that finding was not warranted.

Affirmed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

Mr. Justice FRANKFURTER, dissenting.

The Court holds that the Reconstruction Finance Corporation is not to be treated as an ordinary bondholder-creditor but is entitled to preferred treatment because it acquired the bonds of the debtor as part of an arrangement which made possible financing of the plan of composition. With this I agree. But I find nothing in Chapter IX which, while permitting the R. F. C. to be considered a preferred creditor for purposes of distribution, allows it to be classified among ordinary creditors for purposes of voting. Nor do considerations of policy require that the R. F. C. be given such a two-faced character. It is suggested that if the votes of a preferred creditor in the position of the R. F. C. could not be counted with the votes of the ordinary creditors that class might not furnish the necessary two-thirds of the aggregate amount of claims of that class. It must be remembered, however, that the mere failure of a class like that of ordinary creditors, *e. g.*, those having no preferred position in the scheme for distribution, to accept a plan of composition does not prove that its resistance is improperly or unfairly recalcitrant. *Cf. American Insurance Co. v. Avon Park*, 311 U. S. 138, 148. And recognition that bondholders may exercise their statutory rights as common creditors not to assent does not, of course, make of them a separate class of non-assenting bondholders with a veto power over the plan. But, if the recalcitrancy does represent a dog-in-the-manger attitude, Chapter IX would seem to have provided for the contingency. According to § 83(d) of the Act, 50 Stat. 653, 657, 11 U. S. C. § 403(d), a plan might be approved without the otherwise necessary vote, not only where the claims of the creditors "are not affected by the plan," but also where "provision is made

in the plan for the protection of the interest, claims, or lien of such creditor or class of creditors." But, though the bankruptcy court has the power of dispensing with the need of an approving vote by a class of creditors, by protecting that class' interests, it is not available where the court has not in fact determined, as it has not in this case, that the dissent of that class was an abusive exercise of their right to veto a plan.

To give such flexible scope to § 83(d),¹ though, like other provisions of Chapter IX, it is not free from ambiguity, is the more pertinent if, as suggested, Chapter IX requires approval of two-thirds not of each class of claims but of the total amount of all claims. See Remington, Bankruptcy (1939) § 4364. On the other hand, if approval of the plan by two-thirds of each class is required, such a requirement can only mean that a group of more than one-third of any class is capable of exercising the veto power, except when § 83(d) can be invoked. In establishing these classes, creditors are not properly grouped who, on the face-value of the same bonds, get different equivalents, and are, as to the only thing that matters, not bound together by the same ties but separated by antagonistic interests. To put these groups with such antagonistic interests into the same class is to contradict the very notion of a class. Reason rejects such classification and nothing in the statute indicates that Congress intended to define a class as a group with inconsistent interests.

¹ That this is a reasonable interpretation of § 83(d) is indicated by the cumbersome but more detailed form in which the purpose of § 83(d) is explained in an earlier draft of the Act:

"(3) shall, with respect to creditors whose acceptance is not required under the provisions of subdivision (e) of this section if their interests, claims, or liens are protected in the manner provided in this clause (3), provide adequate protection for the realization by them of the value of their interests, claims, or liens, if the property or revenue affected by such interests, claims, or liens, is dealt with by the plan, either as provided in the plan, (a) by the transfer or sale of such property subject to such interests, claims, or liens, or such property shall continue to be held by the taxing district subject to such interests, claims, or liens, or (b) by a sale free of such interests, claims, or liens, at not less than a fair upset price in the transfer of such interests, claims, or liens, to the proceeds of such sale, or (c) by appraisal and payment in cash of the value of such interests, claims, or liens, or, at the objecting creditors' election, of the securities allotted to such interests, claims, or liens under the plan, if any shall be so allotted or (d) by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case equitably and fairly provide such protection: *Provided*, That if provision therefor is made in the plan, the judge may require objecting creditors to accept, in lieu of any cash payment under this subdivision such security, of any kind, in payment of their interests, claims or liens, as shall, in the opinion of the judge, upon the consummation of the plan, represent the fair and equitable shares of such creditors in the property and revenue of the taxing district available for the payment of its debts. . . . " H. R. 5267, 73rd Cong., 1st Sess. (1933) § 81(b)(3), as it appears in the Hearings on that Bill, at page 17.

